



PROJECT PROPOSAL

PHILIP MORRIS

CIGARETTE MERCHANDISING/CONVENIENCE STORES

CONTROLLED STORE TEST

PHOENIX, ARIZONA - CIRCLE K STORES

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July 7, 1986

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BACKGROUND

Circle K, the second largest convenience store chain in the United States, currently sells cigarettes by the carton but has not aggressively promoted this type of sale. Philip Morris, the nation's largest cigarette manufacturer, has proposed testing self service Philip Morris carton fixtures, value centers, and counter displays in Circle K stores in Phoenix.

Philip Morris has asked Testmark to submit a proposal for testing the self service Philip Morris carton fixtures as well as options for testing value centers, counter displays, and the effect of a reduced retail price.

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OBJECTIVE

The primary objective of this study is to test the impact of installing self service Philip Morris carton fixtures on cigarette sales in Circle K stores. The following measures will be used to make the evaluation:

- Total cigarette volume by manufacturer and selected brands
- Carton-to-pack sales ratio by manufacturer and selected brands
- Inventory depth by manufacturer and selected brands
- Brands in distribution
- Gas versus non-gas store performance
- Average dollar transaction
- Customer traffic count
- Pilferage/shrink

Additionally, this study will serve to determine the effect of installing a Philip Morris value center on cigarette sales performance and determine the value of using counter displays for merchandising cigarettes. The measures listed above will be used for these evaluations also.

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METHODOLOGY

All Options

Technique: Matched panel controlled store test of the random block design

Market: Phoenix

Retail Chain: Circle K

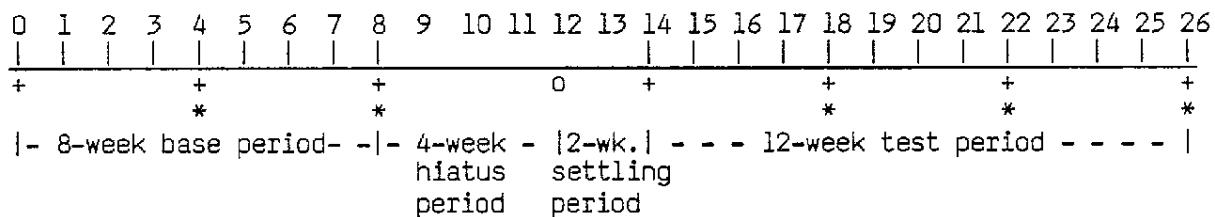
Category Tracked: All cigarettes, cartons and packs

Data Collection Method: 1. ~~Four-week custom store audits~~
2. Weekly PLU (price look-up) information

Length of Study: Twenty-six weeks

- Eight-week base period to collect panel matching data
- Four-week hiatus while panel matching and merchandising changes take place.
- Two-week period to allow merchandising changes to settle
- Twelve-week test period

Study Schematic:



+ = Audits

| = Store checks

o = Merchandising changes completed

* = Four-week reporting periods completed

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All Options continued

Panel Matching Data: Audited sales data and PLU information from an appropriate universe of stores during the eight-week base period, store all-commodity volume (ACV)*, gas versus non-gas units, and qualitative store specific demographics will be used as the panel matching data. If Circle K or its wholesaler, McLane, will provide historical data to Philip Morris then seasonality of cigarette sales will be used as additional panel match data.

Matching Technique: Panel matching data will be gathered as noted above. Using K-means cluster analysis, stores will be grouped into homogenous clusters or blocks. This matching program allows for matching of multiple variables simultaneously and also a subjective weighting of these variables. The stores within a block are randomly assigned to either the test or control treatments.

Frequency of Audits: Every four weeks to all stores during the base period and the test period.

Frequency of Store Checks: Weekly between audits to maintain test conditions, to collect cigarette purchase information and PLU sales data, and to monitor promotional activity.

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* ACV indexes by store will have to be obtained by Philip Morris and Testmark while gaining project cooperation from Circle K.

TEST CONDITIONS

The primary focus of this project is to test the benefits to Circle K of installing self service Philip Morris carton fixtures. There also may be some interest in testing Philip Morris value centers and the value of counter displays. Testmark agrees with Philip Morris that each merchandising variable (carton fixture, value center, and counter display) be identified as a separate test. To save time and expense Testmark recommends adding discrete store panels during the same time frame to accommodate the additional testing variables rather than sequential testing periods. The test conditions are detailed in Options 1A, 1B, and 1C.

Option 1A (Carton Test Only)

Number of Stores Base Period: Forty-five

Number of Stores Test Period: Thirty

Number of Panels: Two (fifteen stores per panel)

Panel I (Control) - No changes will be made in these stores. The stores will maintain their current method of merchandising cigarette cartons, packs, and counter displays.

Panel II (Test) - These stores will be converted to self service carton merchandising on Philip Morris end-cap fixtures.

Option 1B (Cartons and Value Centers)

Number of Stores Base Period: Seventy

Number of Stores Test Period: Forty-five

Number of Panels: Three (fifteen stores per panel)

Panel I (Control) - No changes will be made in these stores. The stores will maintain their current method of merchandising cigarette cartons, packs, and counter displays.

Panel II (Carton Test) - These stores will be converted to self service carton merchandising on Philip Morris end-cap fixtures.

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Option 1B continued

Panel III (Value Center Test) - These stores will be converted to self service carton merchandising on Philip Morris end-cap fixtures and will add one Philip Morris value center.

Option 1C (Cartons, Value Centers, and Counter Displays)

Number of Stores Base Period: Ninety

Number of Stores Test Period: Sixty

Number of Panels: Four (fifteen stores per panel)

Panel I (Control) - No changes will be made in these stores. The stores will maintain their current method of merchandising cigarette cartons, packs, and counter displays.

Panel II (Carton Test) - These stores will be converted to self service carton merchandising on Philip Morris end-cap fixtures.

Panel III (Value Center Test) - These stores will be converted to self service carton merchandising on Philip Morris end-cap fixtures and will add one Philip Morris value center.

Panel IV (Counter Display Test) - These stores will remove all counter displays during the test period. The negative impact of removing counter displays as compared to the control stores will be measured in this panel.

Price Test

After the initial phase of this study, a sequential test can be constructed to measure the effect of a reduced price position in conjunction with self service carton fixtures. This test would be twelve weeks in duration and begin after the original study as outlined in Option 1A.

Number of Stores Test Period: Thirty

Number of Panels: Two (fifteen stores per panel)

Panel I (Control) - No changes will be made in these stores. The stores will maintain their current method of merchandising cigarette cartons, packs, and counter displays.

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Price Test continued

Panel II (Test) - These stores will merchandise carton cigarettes on Philip Morris end-cap fixtures at a reduced retail price.

Store Checks: The weekly store checks will include visits to competing convenience stores to record cigarette pricing levels.

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REPORTS

Testmark will provide Philip Morris with interim reports on a four-week basis. Testmark's customized reporting is flexible in both stub design and column layout. The stub can be designed to include item detail and/or any combination of subtotals or aggregates. Column layouts may be set-up to report store by store detail or trended to show period by period data for all stores combined in the test. In addition to the sales reports, custom graphics will be provided to recap and summarize the data.

The reported measures will include:

- Unit sales or equivalent unit sales
- Retail dollar sales
- Market share of unit sales or equivalent unit sales
- Market share of retail dollar sales
- Retail price
- Inventory depth
- Brands in distribution

The reports will be completed within 15 working days after the end of a reporting period. The initial report may take an additional week to produce. A final report summarizing the project background, test conditions, results, and conclusions will be submitted within four weeks of project completion. Statistical analyses will be provided in this report.

Audited sales data can be reported on an item (packing) specific basis, but with no carton versus package detail. In order to calculate carton-to-pack sales ratio and measure pilferage/shrink it will be important for Philip Morris and Testmark to receive Circle K approval to have store personnel use PLU (price look-up) codes for packs and cartons. Without this, it will be nearly impossible to produce accurate ratio and pilferage reports.

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IN-STORE ACTIVITIES

Testmark will be responsible for the following:

1. Distribution Check - A distribution check visit to an appropriate sample of stores will be conducted. At that time pictures will be taken and existing cigarette merchandising documented by store. This information will be used in matching store panels.
2. Store Audits - During each audit visit, shelf and backroom inventory will be counted, delivery information from all cigarette suppliers accumulated and promotional activity within the category monitored.
3. Store Check Visits - In addition to audit visits, store checks will be conducted during non-audit weeks. During each store check test conditions, delivery information, and promotional activity within the category will be monitored.
4. Trade-Out Documentation - Testmark will initiate a procedure at store level for documentation of cigarette trade-outs.

Philip Morris will be responsible for the following in-store activities:

1. Merchandising Changes/Set-Up - All merchandising changes including placement of carton fixtures and value centers as well as product placement on these fixtures.
2. Product Handling - Any special product handling, delivery, or stocking such as the introduction of Player Lights and Cambridge Lights will be handled by Philip Morris representatives. The product introductions must occur prior to the base period and be consistent across all stores.
3. Trade-Outs - Documentation of all product delivered to stores or removed from stores directly by Philip Morris sales representatives (trade-outs) must be provided to Testmark on a weekly, store specific basis.

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MARKET SUPERVISION

In order to ensure proper test conditions are set-up and maintained, Testmark project directors will provide in-market supervision at the time of the distribution check and initial base period audits, as well as during the first week of the test period audits and throughout the study as needed. This in-market supervision includes training of local market personnel, formal project briefings, in-store supervision, and interaction with store personnel.

RETAIL CHAIN INTERACTION

Testmark and Philip Morris will meet with appropriate Circle K personnel on two occasions. During the first meeting, Testmark will introduce several operational techniques that will allow for additional information from which Circle K may not be currently benefiting. As a third party, Testmark recommends certain procedures which will benefit Circle K beyond the scope of this test. On the second occasion the final test results will be presented to senior Circle K management. Prior to this meeting at Circle K, Testmark will coordinate with Philip Morris at a preliminary presentation in New York.

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TIMING AND FEE

Testmark requires three weeks from final authorization for test set-up activities. During this time the initial meeting with Circle K will take place.

Testmark's fee for this test as proposed is:

Option 1A (carton fixtures only)	\$ 82,000 <u>±</u> 10%
Option 1B (carton and value centers)	+ 19,000 <u>±</u> 10%
Option 1C (cartons, value centers, and counter displays)	+ 19,000 <u>±</u> 10%
Twelve-week price reduction	<u>+ 24,000 <u>±</u> 10%</u>
Total	\$144,000 <u>±</u> 10%

This proposal is contingent on Philip Morris' ability, with assistance from Testmark, in gaining project cooperation with Circle K, including all required data at no expense. Any additions, deletions, or changes to this proposal will be quoted separately.

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CIRCLE K PROPOSAL

ISSUES AND CONCERNS

- Testmark at Philip Morris presentation to Circle K
 - . Gain approval for PLU usage
 - . Invoice availability from Circle K headquarters
 - . Resolve value center issue
 - . Advertising during tests
- Philip Morris will need to gain cooperation from Circle K for average dollar transactions and customer traffic count
- Historical data availability from McLane for determining seasonality
- All manufacturers should be represented on the carton fixture at least through the test period
- No coupon redemption
- Philip Morris will be responsible for all analysis done on average dollar transactions and customer counts
- Need PLU codes to determine volume by pack and carton and to calculate pack-to-carton sales ratio
- Need PLU codes to calculate shrink
- Gas/non-gas stores: segregating test results may require a larger panel of stores

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